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No. 73-_____

73-152

IN THE

Supreme Court of the United States

October Term, 1973

THE FIRST BOSTON CORPORATION,
Petitioner,

v.

CHRIS-CRAFT INDUSTRIES, INC.
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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July 20, 1973.

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IN THE

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THE FIRST BOSTON CORPORATION,
Petitioner,

v.

CHRIS-CRAFT INDUSTRIES, INC.,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner The First Boston Corporation respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this proceeding on March 16, 1973 and modified April 25, 1973.

Opinions Below

The opinion of the Court of Appeals (Jt. App. H-1)[1] is reported at CCH Fed. Sec. L. Rep. ¶ 93,816 (2d Cir. 1973).

[1] The opinions below are reproduced in separate Joint Appendices "A" through "J" referred to herein as "Jt. App.". The opinion of the Court of Appeals has not yet been officially reported. References to ".....A" are to pages of the Appendix filed in the Court of Appeals.

The opinion of the District Court (Jt. App. G-1) is reported at 337 F.Supp. 1128 (S.D.N.Y. 1971). The opinions of the District Court in the related cases of *Securities and Exchange Commission* v. *Bangor Punta Corporation* (Jt. App. C-1) and *Bangor Punta Corporation* v. *Chris-Craft Industries, Inc.* (Jt. App. F-1) in which Petitioner, The First Boston Corporation, was not a party, are reported at 331 F.Supp. 1154 (S.D.N.Y. 1971) and 337 F.Supp. 1147 (S.D.N.Y. 1971), respectively. Prior rulings of the courts with respect to an application for injunction in which Petitioner was not involved (Jt. App. A-1 and B-1) are reported at 303 F.Supp. 191 (S.D.N.Y. 1969) and 426 F.2d 569 (2d Cir. 1970).

Jurisdiction

The decision of the Court of Appeals (Jt. App. H-1) was rendered on March 16, 1973, and its further order modifying the opinion and otherwise denying rehearing (Jt. App. I-1) was entered on April 25, 1973. This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

1. Does Section 14(e) of the Securities Exchange Act of 1934, enacted as part of the "Williams Bill" in 1968 to close the "loophole" in the Securities Laws exposed by a rash of cash tender offers, confer on a contestant for control of a corporation a right of action for damages against the dealer-manager of a competing exchange offer?

2. What is the proper standard of "*scienter*" required to establish liability on the part of a dealer-manager of an exchange offer when the claim is asserted, not by a stockholder to whom the offer was made, but collaterally by a competing contestant for control?

3. Can the Court of Appeals properly find "*scienter*" as a matter of law, contrary to the factual findings of the district court, on the basis of three different and conflicting definitions of the term?

4. Under *Affiliated Ute Citizens of Utah* v. *United States*, 406 U.S. 128 (1972) and *Mills* v. *Electric Auto-Lite Co.*, 396 U.S. 375 (1970) are reliance and causation established as a matter of law from the mere finding of a material omission from a prospectus, not only with respect to a claim asserted by a member of the group to whom the prospectus offer was directed, but also with respect to a collateral claim by a competitor who claims only secondary or consequential damages as a result of the alleged deception of others?

Statutes Involved

Section 14(e) of the Securities Exchange Act of 1934, 78 Stat. 569, as amended, 84 Stat. 1497, 15 U.S.C. §78n(e) (the "1934 Act"), provides in pertinent part:

> "It shall be unlawful for any person to make any untrue statement of a material fact or omit to state any material fact necessary in order to make the statements made, in the light of the circumstances under which they are made, not misleading or to engage in any fraudulent, deceptive, or manipulative acts or practices, in connection with any tender offer or request or invitation for tenders, or any solicitation of security-holders in opposition to or in favor of any such offer, request or invitation."

Because of the established principle that the Securities Act of 1933 and the Securities Exchange Act of 1934 should be construed together, *Securities and Exchange Commission* v. *North American Research and Development Corp.*, 424 F. 2d 63 (2d Cir. 1970), this case also involves Sections 11 and

12 of the Securities Act of 1933, 48 Stat. 82, 84, as amended 48 Stat. 907, as amended 68 Stat. 686, 15 U.S.C. §§ 77k and l (the "1933 Act"), which provide for certain defenses and limitations on liability for "underwriters" in the position of Petitioner, which defenses and limitations are not included in Section 14(e) of the 1934 Act. The text of those provisions is set forth in an addendum to this petition.

The 1934 Act and the 1933 Act are sometimes collectively referred to herein as the "Securities Laws".

Statement of the Case

On the morning of January 23, 1969, Herbert J. Siegel of Chris-Craft Industries, Inc. ("Chris-Craft") called William T. Piper, Jr., President of Piper Aircraft Corporation ("Piper"), to inform him that Chris-Craft had acquired a large block of stock in Piper and that Chris-Craft was that day making a tender offer for additional Piper shares. (227A) On the same day Chris-Craft made a public announcement of the terms of its cash tender offer, pursuant to which Chris-Craft offered to purchase up to 300,000 shares of Piper common stock at $65 per share, with the right, but no obligation, to purchase shares tendered in excess of 300,000. The expiration of the tender offer was set for February 3, 1969. (276A-277A)

Mr. Piper immediately contacted Chadbourne, Parke, Whiteside & Wolff, legal counsel to Piper, Arthur Young & Co., Piper's auditors, and The First Boston Corporation ("First Boston"), Piper's investment bankers. Chadbourne contacted D. F. King & Co., a proxy solicitation firm. (228A) Piper sought advice from these professional advisors concerning the Chris-Craft announcement so that it could have an informed board meeting to determine a course of conduct for the Company.

The Board of Directors of Piper reviewed the prospect of an association with Chris-Craft and having concluded that the Chris-Craft tender offer was not in the best interests of the shareholders of the corporation enacted a resolution to that effect. (238A, 2052A) Thus began the battle for control of Piper which has raged through the marketplace and the courts for over four years. The economic contest ended when Bangor Punta bought 100,614 Piper shares for cash at prices ranging from $66 to $84 per share between August 8 and September 5, 1969 and attained a majority of the outstanding shares. The legal contest began in May of 1969 and it continues.

In so far as Petitioner is concerned, its liability, as found by the Court of Appeals, is based solely on its role as dealer-manager (and hence an "underwriter" as defined in the 1933 Act) for the exchange offer made by Bangor Punta to the shareholders of Piper.

The Bangor Punta exchange offer became effective on July 18, 1969. (447A) On July 22, 1969, Chris-Craft filed "Registration No. 2." The amended offer contained 4 more warants than the previous Chris-Craft exchange offer and at Mr. Siegel's direction was intended to top Bangor Punta's offer. (456A) (1417A) The Chris-Craft package, however, including the $10 cash, never traded above $75.50 and never traded at a price higher than the competing Bangor Punta offer. (483A, 484A) During the time that the two offers directly competed with each other, and during which period the stock market in general and Bangor Punta and Chris-Craft securities specifically declined, the Bangor Punta package traded between $79.93 and $73.37 while the Chris-Craft package traded between $75.50 and $63.25. (24A, 483A, 484A)

On July 29 the Bangor Punta exchange offer closed. Bangor Punta had received 111,628 shares on its offer to bring its total Piper holdings to approximately 45% of

the outstanding Piper shares. (477A, 478A) On August 4, 1969 Chris-Craft's Exchange Offer closed with its having obtained 112,089 additional Piper shares to bring its total holdings to approximately 41% of the outstanding Piper shares. (478A)

On August 4, 1969 after both exchange offers had been concluded, approximately 243,600 or almost 15% of the outstanding Piper shares remained in the hands of shareholders of Piper other than Bangor Punta or Chris-Craft. (478A) These 243,600 shares amounted to *over half* of the Piper shares which were outstanding in the hands of noncombatants when the two competing exchange offers began.

Thus, in early August of 1969, after the long series of purchases, offers and counter-offers extending over a period of eight months, majority control of Piper was still available on the open market to whichever of the two contestants was willing and able to pay the price to acquire the stock.

Chris-Craft made no cash purchases until August 12, 1969 and ceased all purchases on August 18 after acquiring only 29,200 additional share of Piper stock. (479A) Bangor Punta, on the other hand, after obtaining shareholder approval for its exchange offer, immediately began purchasing Piper shares for cash on August 8, 1969 and by September 5, 1969 had acquired 100,614 Piper shares at prices ranging from $84.00 to $66.00 per share giving it more than 50% of the outstanding Piper stock. (478A, 479A)

Thus the long and arduous contest for control of Piper ended in favor of Bangor Punta—not because of any of the claimed violations of law but solely because Chris-Craft lacked the necessary will and resources. (Jt. App. H-115-16)

The claim against First Boston relates only to its role as the dealer-manager named in the prospectus for the Bangor Punta exchange offer. Of all the attacks that have

at various times in this proceeding been launched against Bangor Punta's exchange offer prospectus, only to be abandoned or rejected, one—that relating to the treatment of its investment in its Bangor and Aroostook Railroad Company ("BAR")—has survived and was seized upon by the Court of Apeals as a basis of liability.

Bangor Punta was organized in 1964 as a result of a consolidation of two companies, Bangor and Aroostook Corporation, which owned in excess of 98% of the outstanding BAR shares, and Punta Alegre Sugar Corporation [EV 100]. From Bangor Punta's organization, the BAR was considered an unconsolidated subsidiary for financial reporting purposes and separate financial statements, including balance sheets and income statements, concerning the BAR were always furnished to the public [EV 108-114].

Incorporated in the prospectus, which was dated July 18, 1969 were separate certified financial statements of both Bangor Punta and the BAR for the period ending September 30, 1968, and unaudited statements for the six-month periods ending March 31, 1968 and March 31, 1969. [EV 88-114].* On the Bangor Punta balance sheet appears the item [EV 93]:

	September 30, 1968 (Audited)	March 31, 1969 (Unaudited)
"Investments and Other Assets:		
Investments in unconsolidated subsidiaries (Note 1):		
Bangor and Aroostook Railroad Company	$18,830,746	$18,364,500"

* EV is the abbreviation for Exhibit Volume filed in the Court of Appeals.

The relevant portions of Note 1 referred to above read as follows [EV 99]:

"NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Information Relating to March 31, 1969 is Unaudited)

NOTE 1—Principles of Consolidation:

. . .

At September 30, 1965, the equity in the underlying net assets of the Railroad amounted to $29,791,456, which was $21,694,917 more than the then carrying value. Recognition of this excess was deemed appropriate but it was decided to limit the amount includible in stockholders' equity to $18,384,808 based upon a market price evaluation of the Railroad common stock. This resulted in increasing the carrying amount of the investment in the Railroad and stockholders' equity by $10,288,629. Such restated carrying amount of the investment was $11,406,648 less than the equity in underlying net assets. During the year ended September 30, 1966 the carrying amount of the investment increased by $749,983, representing the cost of 559 shares of capital stock acquired from minority holders and the equity in undistributed earnings for the year, to the amount of $19,134,791, or $11,449,312 less than the equity of $30,584,103 in the underlying net assets of the Railroad. During the year ended September 30, 1967 the carrying amount of the investment decreased by $336,488, representing the excess of dividends paid to the parent over the parent's equity in the earnings of the Railroad, to $18,798,303, or $11,451,123 less than the equity of $30,249,426 in the underlying net assets of the Railroad. During the year ended September 30, 1968 the carrying amount of the investment increased by $32,443, representing the cost of 120 shares of capital stock acquired from minority holders and the equity in undistributed earnings for the year, to the amount of $18,830,746, or $11,465,081 less than the equity of $30,295,827 in the underlying net assets of the Railroad. Separate financial statements of the Railroad are included elsewhere herein. . . ."

The income statement in the prospectus (audited by independent certified accountants except as otherwise indicated) reflected the earnings from Bangor Punta's investment in the BAR as follows:

	Year					Six Months Ended March 31	
	1964	1965	1966	1967	1968	1968	1969
	(Thousands of Dollars)					(Unaudited)	
	Not Reported On By Independent Certified Public Accountants						
Equity in pre-tax income of Railroad (not consolidated) (Note F)	1,140	1,634	912	374	59	(640)	(467)

(F) The equity in the pre-tax income of Bangor and Aroostook Railroad Company and Subsidiaries (Railroad) and the dividends paid to the parent are summarized as follows:

	Year					Six Months Ended March 31	
	1964	1965	1966	1967	1968	1968	1969
	(Thousands of Dollars)					(Unaudited)	
	Not Reported On By Independent Certified Public Accountants						
Total revenues, excluding dividends from parent company	$15,485	$17,112	$ 16,936	$ 17,138	$ 16,417	$7,676	$8,092
Expenses and charges	14,329	15,449	16,011	16,759	16,357	8,325	8,565
Minority interest in income	16	29	13	5	1	(9)	(6)
	14,345	15,478	16,024	16,764	16,358	8,316	8,559
Equity in pre-tax income	$ 1,140	$ 1,634	$ 912	$ 374	$ 59	$ (640)	$ (467)
Dividends paid to parent	$ 141	$ 565	$ 585	$ 585	$ 35	$ 35	$ —

The high level of shipments attributable principally to Maine's widely marketed potato crop in 1965 resulted in a substantial increase in the Railroad's earnings and profit margin for that year. Since 1966 depreciation, interest charges and other costs associated with substantial additions to the Railroad's operating properties and wage increases and related payroll expenses, together with a slowdown in potato shipments, are responsible for decreasing earnings. See the Consolidated Statement of Income of Bangor and Aroostook Railroad Company and Subsidiaries included elsewhere herein.

These statements concerning Bangor Punta's investment in BAR and the income therefrom, while admittedly accurate and in accordance with applicable accounting principles, have been condemned because of the failure to forecast a sale of the stock of BAR for $5 million, which was not authorized by the Board of Directors until September 9—nearly two months after the offering—and not finally agreed upon until October 2, when it was consummated. Had the sale been of the assets of the Railroad, as advocated by the management of Bangor Punta, rather than of the stock, Bangor Punta would not have suffered any loss on its investment, as the sum of the $5 million paid by the purchaser and the tax benefits realizable on consolidation would have at least equalled the carrying figure of the investment. (1804A-1806A, 2166A, EV 276-277, 732-736)

As it was consummated in October, the sale of its investment in the BAR caused Bangor Punta to recognize a book loss, *not a cash loss*, of approximately $13.8 million (807A). Bangor Punta's expert witness testified that, in his opinion, the prudent Piper investor who accepted the Bangor Punta exchange offer ". . . would not have been deterred from so doing" if he had foreseen the October 2nd sale and its consequences [EV 796].

On October 2, 1969, the day before the sale was announced, Bangor Punta Common Stock closed at $21.50 per share on the New York Stock Exchange. On October 3, after the announcement of the sale and the resulting book loss of $13.8 million, Bangor Punta Common Stock closed at $21.00 per share. Between October 2 and October 17, the closing prices for Bangor Punta's Common Stock ranged from a low of $20.50 on October 10 to a high of $24.125 on October 17 [591A]. Thus, the disposition of the BAR, even on the most unfavorable basis, in fact had no discernible adverse impact upon the market value of Bangor Punta securities.

Proceedings Below

This action was initiated by Chris-Craft on May 22, 1969, while the economic contest for control was still being waged. An application for a preliminary injunction was made July 22, 1969 and was denied (Jt. App. A-1) and that denial was affirmed by the Court of Appeals in a decision reported at 426 F.2d 569 (2d Cir. 1970). (Jt. App. B-1)

A related case was initiated by the SEC against Bangor Punta, but not the other defendants in this action. Bangor Punta also filed an action against Christ-Craft. All three cases were consolidated for trial before Judge Milton Pollack in the Southern District of New York. The trial commenced March 9, 1971, and lasted for ten court days. A total of 18 witnesses tetified in person, and Judge Pollack also had before him, and he adopted (45A), findings of fact which had previously been agreed upon by the parties. (208A-757A)

In the related SEC proceeding, Judge Pollack, in his opinion dated August 25, 1971 (Jt. App. C-1) found that the contentions of the SEC—that Bangor Punta had decided on a sale at some undefined time in June, July or August and deferred its consummation to avoid disclosure—as well as the testimony of the only witness presented by the SEC (Frederick R. Dumaine) "lack support both in the credible evidence and in the probabilities. Indeed the evidence which the Court accepts as worthy of belief unequivocally negates any such purpose or plan." (Jt. App. C-11)

Judge Pollack found "Indeed, even after the Board meeting of September 9, information was being supplied to the Board and, on September 29, some of the Board members attempted to block a sale of the stock and bring about a sale of assets. Their reasons were weighty for a sale of assets might permit the reflection of a tax loss as high as $17.7 million. . . ." (Jt. App. C-12)

He continued "The Commission's charge that the sale was a reasonable probability is made from the vantage point of hindsight. In the total perspective of events preceding the sale—including the last minute attempts to convert it into a sale of assets—the Court cannot find that the sale was a reasonable probability at the time and to the people involved." (Jt. App. C-13)

Judge Pollack, however, added that the SEC was claiming more than it needed to assert in a proceeding under Section 11 of the 1933 Act, since the circumstances were such as to indicate that the $18.4 million carrying figure for Bangor Punta's investment in the BAR was "obsolete to the point of being misleading." (Jt. App. C-14) The Court found the omission of "the circumstances surrounding the negotiations for the sale of the BAR interest" to be unintentional but nonetheless material, because of the unique "valuation" nature of the $18.4 million figure, and accordingly ordered Bangor Punta to make a rescission offer to those Piper stockholders who had accepted the exchange offer. (Jt. App. C-16, C-18)

In a supplemental memorandum dated September 17, 1971, Judge Pollack stated:

> "It is beyond the scope and intent of the opinion of August 25, 1971 to consider or decide what constitute accepted principles of accounting in the abstract. The opinion deals solely with the requirements of a prospectus used on an exchange of securities and what is to be considered misleading in connection therewith. Any differences between accepted principles of accounting and fair disclosure in a prospectus must be resolved in favor of the disclosure requirements of a prospectus which essentially are a management not an accountant's responsibility." (Jt. App. D-1)

By an additional supplemental memorandum, dated November 17, 1971, Judge Pollack settled the form of the decree, which was entered on that date. (Jt. App. E-1)

In the instant proceeding, in an opinion dated December 10, 1971 (Jt. App. G-1), reported at 337 F.Supp. 1128 (S.D.N.Y. 1971), Judge Pollack held that Chris-Craft had standing to assert a claim under Section 10(b) and Rule 10b-6 of the 1934 Act with respect to certain cash purchases of Piper stock with which Petitioner is not concerned.

While he described Chris-Craft's assertion of standing to sue under Rule 10b-5 as of "highly dubious validity" the trial judge held it was "unnecessary to decide whether § 14(e) may be separately invoked by one competitor for corporate control against another", since he otherwise concluded that Chris-Craft had failed to prove a case against the defendants. (Jt. App. G-9)

With respect to the complaint against Bangor Punta's registration statement, Judge Pollack referred to his finding in the SEC case that the registration statement was "unintentionally in error in failing to disclose the circumstances which rendered Bangor Punta's carrying figure of the BAR holding obsolete and misleading absent such disclosure." (Jt. App. G-19) Judge Pollack observed that this "result expressed the principal that a registration statement with a misleading effect should be corrected *for those to whom it related*, whether or not the error was made with intent to mislead." (Italics supplied) However, noting that Chris-Craft was in quite a different position, as it was not a purchaser suing under Sections 11 and 12 of the 1933 Act, Judge Pollack concluded (Jt. App. G-20):

> "We have no doubt that a violation of the registration requirements can, also, be a violation of Section 10b(5) and 14(e) of the Securities Exchange Act. But the mere fact of a violation of registration requirements under the '33 Act does not automatically trigger Section 10b and Rule 10b-5. The reasons and basis for invoking the '34 Act provisions must exist independently. The essentials are material deception, some form of scienter and a causal relation between the deficiency and the harm complained of. These essential elements

have not been established in this case. At a minimum, neither a form of scienter nor proof of causal effect was established here."

Distinguishing *Mills* v. *Electric Autolite*, 396 U.S. 375 (1970) because that action was brought by the affected stockholders themselves, Judge Pollack added (Jt. App. G-21):

> "This does not aid Chris-Craft as it is seeking to recover because of the effect which a misstatement allegedly had on third parties.
>
> "A Piper holder's decision to tender to Bangor Punta and Chris-Craft's failure to acquire the shares of such a holder cannot be held to be so clearly tied to the registration statement, as to obviate the need for proof which would, at least, indicate a causal connection producing damage to Chris-Craft."

Thus the trial judge expressly found that, assuming it had standing under Rule 10b-5, Chris-Craft had failed to prove any case for damages thereunder. As to Section 14(e), Judge Pollack found the requirements thereunder to be no less than those of Rule 10b-5. "In the context of the facts of this case," Judge Pollack found (Jt. App. G-23), "Section 14(e) adds no weight to contentions of Chris-Craft that it need not establish a nexus between the violations it charges and the damages it claims to have suffered."

On the entire record, the Court held that Chris-Craft had failed to establish a basis for assessing liability against any of the defendants. (Jt. App. G-37)

In addition, with respect to petitioner, First Boston, and two of its officers, who were also named as defendants, Judge Pollack made the following specific findings:

> "First Boston and Paul L. Miller and Nicholas H. Bayard of First Boston (the "First Boston defend-

ants") were joined as parties defendant herein. On the basis of the record, the Court cannot find that they committed, or engaged in any course of conduct which operated as fraud or deceit upon Chris-Craft or the public shareholders of Piper.

"Indeed, were the record to support Chris-Craft's claims with respect to Piper and Bangor Punta (which it does not) the Court would be hard put to find any basis for extending liability to the First Boston defendants.

"First Boston, in its capacity as an investment banker, rendered a variety of professional services to Piper Aircraft Corporation, Bangor Punta and members of the Piper family. In each case, substantive decision making power rested with and was exercised by these clients and not First Boston. First Boston was not responsible for the Piper letter to shareholders dated January 27, 1969. There is no evidence that it did more than contribute to the letter a suggestion within its area of expertise (investment prospects in the light aircraft industries generally), of which plaintiff does not complain.

"The suggestions to Piper made by the First Boston defendants in respect to: the cash tender offer by Chris-Craft, the Grumman agreement, the press release concerning Grumman, the U.S. Concrete and Southply transactions, the May 8, 1969 agreement between Bangor Punta and the Piper family, the May 8, 1969 press release in connection therewith, the purchases by Bangor Punta of large blocks of Piper and the prospectuses on the Piper exchange offer, were a legitimate exercise of and limited to professional advice within the area of expertise of First Boston.

"The activity of First Boston in the course of its professional relations with Piper, the Piper family and Bangor Punta does not render it responsible or

liable for the actions of its clients. The record compels the conclusion that the First Boston defendants acted solely in the furtherance of what they believed in good faith to be the legitimate interests of their clients." (Jt. App. G-34-35)

Chris-Craft appealed, and the Court of Appeals reversed with each member of the three-judge panel, Judges Timbers, Gurfein and Mansfield, writing an opinion (Jt. App. H-1 to H-95, H-95 to H-100, H-100 to H-124), holding all defendants jointly and severally liable to Chris-Craft, as a matter of law, for "the reduction in the appraisal value of [Chris-Craft's] Piper holdings attributable to [Bangor Punta's] taking a majority position and reducing [Chris-Craft] to a minority position, and thus being able to compel a merger at any time." (Jt. App. H-69) At the same time the Court of Appeals directed that Bangor Punta be enjoined "from voting for a period of at least 5 years the Piper shares it obtained through the unlawful May cash purchases and those it obtained through its exchange offer." In the SEC case, Bangor Punta is also directed to make a rescission offer to those Piper stockholders who accepted its exchange offer. (Jt. App. C-16)

Citing a "policy of vigorous enforcement through private litigation" which "has been the instrument for forging many salutary developments in the securities fraud area, including a broadening of standing to sue and a relaxation of the elements of proof in a private action" (Jt. App. H-18), the Court of Appeals rejected the determinations of the trial judge on the facts, substituted new ones of its own and effectively eliminated any requirements of standing or proof of causation.

The Court of Appeals held that Chris-Craft had standing to sue under Section 14(e) of the 1934 Act, and accordingly, it was unnecessary to decide whether it had standing to sue under Rule 10b-5. (Jt. App. H-23)

As to causation, citing *Mills* v. *Electric Auto-Lite*, *supra*, and *Affiliated Ute Citizens* v. *United States*, *supra* as establishing in class actions "a presumption of reasonable reliance in order to avoid an overly difficult burden of proof" in order "to encourage the vigorous enforcement of the securities laws through shareholders' suits, the Court of Appeals extended the principle therein established to eliminate any necessity of proving causation in fact "in the context of a suit under Section 14(e) by an offerer against the target corporation and its allies." (Jt. App. H-58)

Judge Timbers concluded (Jt. App. H-60), "Since BPC eventually acquired only about 51% of the outstanding Piper shares, it is clear that the 7% acquired through its exchange offer was critical to its success. Reliance and causation have been shown."

With respect to the basis of liability of petitioner as a statutory underwriter under Section 14(e), Judge Timbers noted that representatives of First Boston read certain minutes referring to the developments concerning the BAR and questioned Bangor Punta's management about it and were informed that there were no plans at the time to dispose of the railroad. Judge Timbers then leaped to the conclusion that this "was the full extent of First Boston's investigation." (Jt. App. H-48) He then ruled (Jt. App. A-49):

> "We believe that § 14(e) imposes liability upon an underwriter in favor of a competing offeror, specifically where the misrepresentation occurs in the context of a contest for control. An underwriter is liable under § 14(e) as an aider and abettor of the issuer if he was aware of a material falsity in the registration statement or was reckless in determining whether material falsity existed."

Judge Timbers stated that First Boston "was duty bound to make a reasonable further investigation" and then,

despite the absence of any such proof in the record and the contrary findings of the trial judge, further concluded that it "did not adequately perform its duty in these respects". (Jt. App. H-51) On that basis he found the requisite "*scienter*" or "culpability" to warrant imposing liability even to a collateral claimant like Chris-Craft.

In his concurring opinion, Judge Gurfein referred to the requisite *scienter* as follows (Jt. App. H-95):

> "I agree that some kind of scienter must be shown. But I do not think a litmus paper test of scienter will ever be found. I am content to accept the general formulation that mere negligence will not suffice in a private action for money damages and that "recklessness that is equivalent to wilful fraud," *SEC* v. *Texas Gulf Sulphur Co.*, 401 F.2d 833, 868 (Friendly, *C.J.* concurring), is required for a violation of Section 14(e) as well as of Section 10(b). In modern times statutory construction grows case by case much as the common law did when more general rules of law were involved. And I venture to say that stability may be more easily attained by analogizing from decided cases whose facts are known than by guessing what may come within some general rule which must of necessity be inchoate if only for want of the gift of prophecy."

While concurring in Judge Timbers' finding of liability against petitioner in its capacity as a statutory underwriter "solely upon the principle of implying liability as a means of promoting private enforcement of the antifraud provisions of the securities laws", Judge Mansfield noted (Jt. App. H-116):

> ". . . unlike the main opinion on this issue, I gain no assistance in reaching that decision from § 11(b) of the 1933 Act, 15 U.S.C. § 77k(b) or from the Senate Report accompanying § 14(e), S. Rep. No. 510, 90th Cong., 2d Sess. (1968).

Since § 11(b) *expressly* creates liability for materially misleading statements in a prospectus and then only in favor of purchasers of the security, I fail to find it of any help in *implying* liability under § 14(e) in favor of nonpurchasers. Indeed it could be argued that the very fact that Congress expressly delineated the scope of liability in § 11(b) militates against implying liability in § 14(e). As for the Senate Report accompanying § 14(e), I believe the authors would be startled to find that they had in mind underwriters such as First Boston Corp. when they referred generally to persons "engaged in making . . . tender offers or otherwise seeking to influence" the decision of investors with respect to such offers."

Reasons for Granting the Writ

First and foremost the writ should be granted so that the much-vexed question of "*scienter*" in cases under Rule 10b-5 and Section 14(e) can be authoritatively settled. Not only is the question of *scienter* in conflict between the circuits (compare *Ellis* v. *Carter*, 291 F.2d 270 (9th Cir. 1961) with *Shemtob* v. *Shearson, Hammill & Co.*, 448 F.2d. 442 (2d Cir. 1971)) but also there has been a square conflict with the instant case in a more recent *in banc* decision within the Second Circuit itself. See *Lanza* v. *Drexel*, CCH Fed. Sec. L. Rep. ¶ 93,959 (2d Cir. 1973) at p. 93,844, where Judge Timbers, who wrote the opinion of the Court in the instant case, cites it in his vigorous dissent from the majority decision. The instant case is an appropriate vehicle for the review of the question, for the findings of fact of the trial court which were not overturned by the Court of Appeals confirm the essential good faith and honesty of the defendants. While the Court of Appeals used epithets of "recklessness", it is plain that Petitioner did not act recklessly, but in fact has been held liable to a collateral claimant (not an investor with whom it dealt) for a differ-

ence of judgment with the judges of the Court of Appeals —a matter of investment judgment as to which investment bankers like First Boston could be expected to be more expert than lawyers or judges.

If, as Chief Judge Friendly indicated in *Electronic Specialty Co.* v. *International Controls Corp.*, 409 F.2d 937 (2d Cir. 1969), another Second Circuit decision in apparent conflict with the instant case, Congress intended in Section 14(e) to require "basic honesty and fair dealing", the instant case is a gross misapplication of the intent of the statute. Prompt and authoritative settlement of the vexations question of *scienter*, particularly as applied to professional underwriters like Petitioner, is of vital importance to the deeply troubled securities industry. See *H. Kook & Co.* v. *Scheinman, Hochstin & Trotta, Inc.*, 414 F.2d 93 (2d Cir. 1969) where the Court states at page 98:

> "Moreover, we are well aware that the laws governing the securities market become more intricate and finely spun daily. Some engaged in the business of securities trading believe themselves to be characters from Victorian novels wandering aimlessly on treacherous moors. There is much appeal in the contention that brokers and dealers should be able to rely on the few signposts that appear in this confused terrain."

In addition to the question of *scienter*, the instant case is also the first to reach this Court on the important question of standing to sue under Section 14(e). Under the sometimes criticized, but universally followed, case of *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2d Cir. 1952) *cert. denied* 343 U.S. 956 (1952), the rule has been settled that only purchasers or sellers of securities have standing to sue for damages under Rule 10b-5. See *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971).

The Court of Appeals here has ruled for the first time that the frustrated buyer—one who claims he might have

bought but for the misconduct of defendants—has standing to sue for damages under the comparable provisions of Section 14(e), not because the statute was intended for the protection of aggressors like Chris-Craft, but solely to advance a supposed policy of fostering private enforcement of the Securities Laws. This conflicts squarely with the opinion of Judge Friendly in *Securities and Exchange Commission* v. *General Time Corporation*, 407 F.2d 65 (2d Cir. 1968) where that learned judge stated (p. 70):

> "We fully recognize the principle, affirmed in *J. I. Case Co.* v. *Borak*, 377 U.S. 426, 432, 84 S.Ct. 1555, 1560, 12 L. Ed. 2d 423 (1964), that private enforcement 'provides a necessary supplement to Commission action,' to effect compliance with securities legislation. Indeed, we were the first Court of Appeals to uphold private actions to enforce duties created by the Investment Company Act. [citations omitted] *But this does not mean that any person may sue.* . . .
>
> "To allow a company whose shares were being acquired by an affiliate and an investment company without the prior approval required by § 17(d) and Rule 17d-1 to act as a 'private attorney general' to enforce the Investment Company Act, [citation omitted] would stretch that doctrine well beyond the bounds limned by its author." (Italics supplied)

The effect of Judge Timbers' ruling on standing in this case is to destroy the limitations on liability which Congress included in Sections 11 and 12 of the Securities Act of 1933 for underwriters, officers and directors, experts and other laborers in the vineyard who are not the principals in the sale of securities, contrary to the generally accepted principle that the 1933 and 1934 Acts are to be construed together as part of a single regulatory scheme. See *Securities and Exchange Commission* v. *North American Research & Development Corp.*, *supra* at pp. 81-2.

Moreover, the Court of Appeals in the instant case has, we submit, extended the doctrine of *Mills* v. *Electric Auto-Lite, supra,* and *Affiliated Ute Citizens of Utah* v. *United States, supra,* far beyond their limits. The trial court ruled that, Chris-Craft had failed to prove it had any reasonable expectation of acquiring the shares it sought, regardless of the conduct of defendants. Giving full effect to the presumptions suggested in *Mills* and *Affiliated Use* does not reach that question. Nothing in either of those cases suggests that proof of such an interest by a competitor for the shares is to be displaced by a rule of law.

The trial judge found a total "absence of evidence establishing a reasonable probability that its defeat and damage were connected with the claimed violations." (Jt. App. G-21) The Court of Appeals—without taking any new evidence but relying instead on testimony from a Chris-Craft officer which the trial judge did not credit—found sufficient probabilities of success on Chris-Craft's part to invoke the common law doctrine of "interference with a prospective advantage" (Jt. App. H-30, H-61-62, H-113-115) although the standards applicable in such cases require a near certainty that the claimant would have gained the day but for defendants' *malicious* interference, none of which appears in the instant case. See *Harrison* v. *Prather,* 435 F.2d 1168 (5th Cir. 1970) *cert. denied* 404 U.S. 829 (1971); *Lewis* v. *Bloede,* 202 F. 7, 17 (4th Cir. 1912); *Union Car Advertising Co.* v. *Collier,* 263 N.Y. 386, 189 N.E. 463 (1934).

Finally, in this instance and in others, the Court of Appeals so far overstepped the bounds of the "clearly erroneous" rule (Rule 52a, Federal Rules of Civil Procedure) in disregarding findings of fact made by the trial judge, including the ultimate facts of *scienter* and causation, and then substituting its own findings of fact on crucial issues, without support in the record, that review and reversal are required in the exercise of this Court's power of supervision of the lower Federal courts.

The Court of Appeals effectively admitted its error in this respect by changing its ruling on the two individual First Boston defendants following the petition for rehearing with the lame explanation that the record is "voluminous." (Jt. App. I-2). The principle is the same as to The First Boston Corporation. If the Court of Appeals could not properly find the facts from the record, voluminous or otherwise, against the individuals, it could not properly find the facts against the Corporation.

I. The standard for "scienter" should be set as one of basic honesty and fair dealing.

At the present time, the standard for liability under Rule 10b-5 and Section 14(e) is in total disarray. The extent of the confusion is indicated in Judge Timbers' opinion which cites and apparently purports to follow (Jt. App. H-36) *Ellis* v. *Carter*, 291 F.2d 270, 274 (9th Cir. 1961) and *Royal Air Properties, Inc.* v. *Smith*, 312 F.2d 210, 212 (9th Cir. 1962), which represent one end of the spectrum in rejecting any requirement of *scienter* and Judge Friendly's standard of "basic honesty and fair dealing" in the *Electronic Specialty* case, *supra*, at the other. (Jt. App. H-34)

Confusion abounds, not only among the circuits but between different courts and panels of courts within the same circuit. See VI L. Loss, Securities Regulation, pp. 3884-88, 2 A. Bromberg, Securities Law—Fraud—Rule 10b-5, § 8.4 (501).

The first and third circuits are generally regarded as requiring *scienter*—a knowing misrepresentation or fraud on the basis, respectively, of *Carr* v. *Warner*, 137 F. Supp. 611 (D. Mass. 1955) and *Kohn* v. *American Metal Climax, Inc.*, 458 F.2d 255 (3rd Cir. 1972) *cert. denied* 409 U.S. 874 (1972).

The fifth circuit seems to have bowed in all directions on the *scienter* question without expressly taking any position on the point. Compare *Herpich* v. *Wallace*, 430 F.2d

792 (5th Cir. 1970) and *Shell* v. *Hensley*, 430 F.2d 819 (5th Cir. 1970) with *Clement A. Evans & Co.* v. *McAlpine*, 434 F.2d 100, 103 (5th Cir. 1970) *cert denied* 402 U.S. 988 (1971).

The situation in the sixth circuit is unclear, but two decisions have indicated that little more than negligence, if anything, is required. See *Mader* v. *Armel*, 461 F.2d 1123 (6th Cir. 1972) *cert denied* 409 U.S. 1023 (1972) and *Texas Continental Life Ins. Co.* v. *Bankers Bond Co.*, 187 F.Supp 14, 23 (W.D. Ky. 1960) rev'd on other grounds *sub nom. Texas Continental Life Ins. Co.* v. *Dunne*, 307 F.2d 242 (6th Cir. 1962). But *Golob* v. *Nauman, Vandervoot, Inc.* CCH Fed. Sec. L. Rep. ¶ 93,979 (N.D. Ohio 1972) holds "It is insufficient to allege mere negligence" (p. 93,916). The seventh and eighth circuits seem to be following a rule of negligence, *Kohler* v. *Kohler Co.*, 319 F.2d 634, 642 (7th Cir. 1963), *Vanderboom* v. *Sexton*, 422 F.2d 1233, 1238-40 (8th Cir. 1970) *cert. denied* 400 U.S. 852 (1970). While the tenth circuit at one time seemed to be following *Ellis* v. *Carter* in saying no *scienter* is required, *Stevens* v. *Vowell*, 343 F.2d 374 (10th Cir. 1965); the more recent decision in *Mitchell* v. *Texas Gulf Sulphur* 464 F.2d 90, 97 (10th Cir. 1971) *cert. denied* 404 U.S. 1004 (1971) seems to have set a standard of requiring a "due diligence" defense as under Section 12(2) of the 1933 Act.

This confusion over the key factor of *scienter* has been the source of judicial conflict and even judicial metaphor, variously referred to as: "this thicket"—Judge Medina in *Heit* v. *Weitzen*, 402 F.2d 909, 914 (2d Cir. 1968) *cert. denied* 395 U.S. 903 (1969); "the still clouded cauldron in which the oracles continue to stew"—Judge Frankel in *Lanza* v. *Drexel & Co.*, CCH Fed. Sec. L. Rep. ¶ 92,826 at p. 90,103 (S.D.N.Y. 1970); "the great debate"—Judge Kaufman in *Globus* v. *Law Research Service, Inc.*, 418 F.2d 1276, 1291 (2d Cir. 1969), *cert. denied* 397 U.S. 913 (1970).

In the instant case alone, the three judge panel offered three separate prescriptions, and within weeks after the decision in the instant case a decision *in banc* was handed

down in the second circuit which, as to First Boston, is fundamentally inconsistent with the instant case. *Lanza* v. *Drexel & Co.*, CCH Fed. Sec. L. Rep. ¶ 93,959 (2d Cir. 1973).

Lanza v. *Drexel*, like the instant case, involved an appeal from dismissal of a 10b-5 suit. In that case the appeal involved the liability of a director, rather than an underwriter, but directors and underwriters are treated similarly under the 1933 Act in that each is under a duty of due diligence but is not an absolute guarantor of the accuracy and completeness of the prospectus. Each also is entitled to rely on independent auditors' opinions as to the financial statements. Each also has limits placed on the total liability that can be imposed. See §§ 11(e) and 11(g) of the 1933 Act.

Note, however, the different law laid down by Judge Moore in *Lanza* v. *Drexel* as follows (p. 93,813):

> "As will be developed *infra*, neither the language nor intent of Section 10(b) or Rule 10b-5 would justify a holding (1) that a director is an insurer of the honesty of individual officers of the corporation in their negotiations which involve the purchase or sale of the corporation's stock or (2) that, although he does not conduct the negotiations, participate therein, or have knowledge thereof, he is under a duty to investigate each such transaction and to inquire as to what representations had been made, by whom and to whom, and then independently check on the truth or falsity of every statement made and document presented.
>
> "Were a contrary result to be reached it would, in effect, place an affirmative duty on Coleman (and on all other directors) to intervene personally in every transaction involving the sale or exchange of BarChris stock and would amount to a holding that a director's vote of approval for any such transaction negotiated and concluded by others, without his knowledge or par-

> ticipation, would be a representation to such purchasers that the director personally had inquired as to the facts upon which the negotiations were based and that he was satisfied that all representations were correct."

Judge Timbers, in similar circumstances, and with no more cause, imposed a duty to investigate on First Boston, including intervening in the negotiations with Amoskeag in which it had no proper role to play and found, solely on the basis of its role as an "underwriter", that it did thus "certify" the registration statement. (Jt. App. H-80)

Compare also Judge Timbers' use of the analogy of Section 11 of the 1933 Act as a reason for imposing liability on the underwriter in the instant case (Jt. App. H-44) with Judge Moore's citation of the same analogy (CCH Fed. Sec. L. Rep. at p. 93,822) as a reason for not imposing liability on the director under Rule 10b-5 in the *Lanza* case. It is submitted that Judge Moore's carefully documented analysis of the legislative history has the better of the argument.

After analyzing several precedents, not including the instant case, Judge Moore confirms (CCH Fed. Sec. L. Rep. at p. 93,828):

> "Other cases in this circuit clearly indicate that "facts amounting to *scienter*, intent to defraud, reckless disregard for the truth, or knowing use of a device, scheme or artifice to defraud" are essential to the imposition of liability."

Judge Moore's refusal to hold a director "liable in damages for failing to *insure* that all material, adverse information is conveyed to prospective purchasers" (CCH Fed. Sec. L. Rep. at p. 93,829) is totally inconsistent with Judge Timbers' insistence in this case that First Boston's "certification" of the registration statement afforded a basis, despite its complete good faith, for imposing liability in favor of a collateral claimant who did not purchase the

securities for which First Boston was a statutory "underwriter".

The Court of Appeals in *Lanza* required for exoneration only that the director's failure to discover the fraud was not "willful" or "calculated". No one has suggested that First Boston's conduct was in any way "willful" or "calculated". The trial judge expressly found the contrary, and his findings in that regard are amply supported by the record.

The ruling of the Court of Appeals in *Lanza* was completely inconsistent with the treatment accorded First Boston in the instant case, and the inconsistency is underscored by Judge Timbers' dissent in *Lanza*, citing the instant case. (CCH Fed. Sec. L. Rep. at p. 93,844)

Judge Moore, in speaking for the panel of the entire Second Circuit *in banc*, refers to the conflict and confusion on the question of *scienter* among the different circuits and even within the Second Circuit.

Clarification of this important question is of vital importance to the continued functioning of the securities industry. This Court can and should provide clarification in the instant case. The industry needs a standard under which honest men can function without fear of extensive liabilities resulting from mere differences of judgment with an appellate court looking at the matter with hindsight several years later.

II. Chris-Craft is not within the group intended to be protected by Section 14(e), and has no standing to sue for damages thereunder.

Well before the addition of Section 14(e) to the 1934 Act, the law was settled in *Birnbaum* v. *Newport Steel Corporation*, 193 F.2d 461 (2nd Cir. 1952) *cert. denied* 343 U.S. 1956 (1952) that to have standing to sue under Rule 10b-5, a plaintiff must allege that he purchased or sold a security,

and that such purchase or sale was the result of fraud by the defendant.

Although the purchaser-seller requirement has been the subject of academic criticism, *Birnbaum* remains the law. *Superintendent of Insurance* v. *Bankers Life & Casualty Co., supra.*

Section 14(e) was added to the Securities Exchange Act of 1934 in July of 1968. Despite its recent origin, it has already given rise to a multitude of actions, and the financial pages are reporting additional cases nearly every day as the depressed market and cheap dollars are encouraging a new rash of tender offers, many by foreign corporations. The instant case is the first Court of Appeals decision, however, to hold that it affords a frustrated competitor for control standing to sue for damages. The question is pending in the Court of Appeals for the First Circuit in an appeal from *Porter (H.K.) Company, Inc.* v. *Nicholson File Company,* 353 F.Supp. 153 (D.R.I. 1972).

Section 14(e) was enacted following the wave of cash tender offers that had become increasingly popular in the mid-sixties. The reports of the House Commerce Committee and the Senate Committee on Banking and Currency, the Congressional committees which considered the legislation, refer to the increasing use of the cash tender offer to acquire control of corporations, the fact that existing legislation did not require disclosure to investors of any facts concerning the offeror, and the need to enact legislation which would require disclosure to shareholders. S. Rep. No. 550, 90th Cong., 1st Sess. 1-3 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 2-3 (1968).

The reports leave no doubt that the class the legislation was designed to protect was not the offeror, but the shareholders of the target corporation. The entire thrust of the reports is the need for protection from, not protection for,

the offeror. Thus the Senate report describes the need for the legislation as follows:

> "The cash tender offer has advantages over the proxy contest as a means of obtaining control of a corporation. One such advantage is that by using a cash tender offer the person seeking control can operate in almost complete secrecy. At present, the law does not even require that he disclose his identity, the source of his funds, who his associates are, or what he intends to do if he gains control of the corporation. As a practical matter, unless incumbent management explains its position publicly, the investor is severely limited in obtaining all of the facts on which to base a decision whether to accept or reject the tender offer.
>
> "The public shareholder must, therefore, with severely limited information, decide what course of action he should take.
>
> • • •
>
> "Without knowledge of who the bidder is and what he plans to do, the shareholder cannot reach an informed decision. He is forced to take a chance. For no matter what he does, he does it without adequate information to enable him to decide rationally what is the best possible course of action.
>
> • • •
>
> "This bill is designed to make the relevant facts known so that shareholders have a fair opportunity to make their decision." S. Rep. No. 550, 90th Cong., 1st Sess. 2-3 (1967).

The House committee report contains substantially similar language. H. Rep. No. 1711, 90th Cong., 2d Sess. 2-3 (1968).

That the investors whom Congress sought to protect were the shareholders of the target corporation and not the offeror is further evidenced by a reference in the Section of the reports entitled "Protection of Investors". Denying any intent to discourage takeover bids, the reports state that the legislation is needed to protect investors "caught in the midst of a battle for corporate control". S. Rep. No. 550, 90th Cong., 1st Sess. 4 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 4 (1968).

The hearings which preceded the committee reports confirm that the concern of Congress was the shareholders of the target corporation. Throughout the hearings, witnesses and legislators stated the need for protecting the target shareholders, and the single witness who addressed himself to the subject specifically stated that the offeror did not need protection. Testifying before the Senate committee, Professor Samuel Hayes, III of the Columbia Business School said:

> "The two major protagonists—the bidder and the defending management—do not need any additional protection in our opinion. They have the resources and arsenal of moves and counter moves which can adequately protect their interests. Rather, the investor—who is the subject of intrigues of both major protagonists—is the one who needs a more effective champion and this is an important point." Hearing Report on S. 510 Before Subcom. of Securities of the Senate Committee on Banking and Currency, 90th Cong., 1st Sess. 57 (1967).

The concern for the shareholders of the target corporation rather than the protagonists seeking control is also evident in the section of the committee reports explaining Section 14(e). Both reports define the object of the Section as that of obliging the protagonists to make full disclosure

"to those with whom they deal", *i.e.*, the shareholders. The reports state:

> "This provision would affirm the fact that persons engaged in making or opposing tender offers or otherwise seeking to influence the decision of investors or the outcome of the tender offer are under an obligation to make full disclosure of material information to those with whom they deal." S. Rep. No. 550, 90th Cong., 1st Sess. 11 (1967); H. Rep. No. 1711, 90th Cong., 2d Sess. 11 (1968).

The foregoing legislative history gives abundant evidence that Congress's concern in enacting Section 14(e) and the other amendments embodied in the Williams Bill was for the shareholders of the target corporation. In view of this clear evidence of Congressional purpose, there is no basis for according standing to a party who was not an object of Congressional concern, nor is there any basis for formulating an additional cause of action which has hitherto been unknown in the Federal securities laws.

Certain cases have permitted the contestants to bring prophylactic injunctive proceedings as representatives or proxies acting in the interests of those stockholders *Electronic Specialty Co.* v. *International Controls Corp.*, *supra*, *Butler Aviation International, Inc.* v. *Comprehensive Designers, Inc.*, 425 F.2d 842 (2d Cir. 1970). In the instant action, however, the situation is quite different. Chris-Craft seeks no prophylactic injunctive relief that would aid Piper shareholders; it seeks only money damages for itself. Ironicaly, it seeks those damages on the basis of its failure to persuade a sufficient number of those stockholders to exchange the stock they owned in Piper for equity securities of Chris-Craft, which, as events proved, would have been an unfortunate bargain for them to make. Contrary to the situation in *Electronic Specialty* and in *Butler Aviation*, according Chris-Craft standing to seek recoupment of its losses would in no way assist the class which Congress

sought to protect in enacting Section 14(e). In no way can Chris-Craft be viewed an an appropriate representative or proxy acting for the stockholders of Piper.

If deceptive statements misled any Piper shareholder into an action contrary to his own best interest which he would not otherwise have taken, the damage claim is his, not Chris-Craft's. He is free now to ratify the transaction if he so chooses. Chris-Craft has no say in the matter and should have no standing to complain of it.

This factor has been found to be a compelling consideration in refusing standing to all strangers to the transaction under Rule 10b-5. See *Greater Iowa Corporation* v. *McLendon*, 378 F.2d 783, 792 (8th Cir. 1969); *Mt. Clemens Industries* v. *Bell*, 464 F.2d 339 (9th Cir. 1972). Since these considerations derive from the "voidability" provisions of Section 29(c) of the 1934 Act which are equally applicable both to Section 10b and to Section 14(e), they should lead to the same conclusion in the instant case.

Section 14(e) was intended for the protection of the stockholders of the target company, and under established principles of law only members of that group should have any implied right of action for damages thereunder. *Crane* v. *Cedar Rapids & I.C. Ry.*, 395 U.S. 164 (1968); *Texas & Pacific Ry.* v. *Rigsby*, 241 U.S. 33 (1916).

Moreover, in holding that Chris-Craft, as the frustrated aggressor, had standing to sue First Boston for damages under Section 14(e) of the 1934 Act, simply because it was an "underwriter", as defined in the 1933 Act, the decision of the Court of Appeals does violence to the intent of Congress. Congress recognized in the Securities Laws as a whole that some balance is required or the risks of liability will drive the honest man as well as the dishonest one into inactivity.

For this reason Congress in Section 11 of the Securities Act of 1933 carefully added limitations on the liabilities it imposed on underwriters, specifically including Section

11(c) and Section 11(b)(3). The instant case, by according standing to a collateral claimant, has swept aside all those limitations.

The purpose of the Williams Bill was the protection of the shareholders of the target company, in this case Piper, not aggressors in the position of Chris-Craft. In one swoop, the Court of Appeals has moved Chris-Craft into the protected group and at the same time ripped away the protections Congress has afforded underwriters, *even as against persons who are in the protected group.*

Because of the importance of this matter to the securities industry, this novel ruling of the Court of Appeals merits the prompt attention of this Court. The financial papers are reporting contested take-overs and ensuing litigation every day. The lower courts are already grappling with a flood of cases, and authoritative determination of the questions posed in this case is vital to the efficient handling of such actions at every judicial level. Such an authoritative determination would also greatly assist the bar in advising clients of the risks involved in acting as dealer-manager for such offerings, and the compensation required to warrant taking those risks without the protection of the limitations provided in the 1933 Act.

III. No rule of law excuses Chris-Craft from proving that the misconduct of defendants caused the damages of which it complains.

The Court of Appeals here apparently found such a rule of law in the opinions of this Court in *Mills* and *Affiliated Ute*. It is submitted that those decisions go no further than to authorize the factual inference, in appropriate circumstances, that an offer would not have been accepted by a large group of offerees if they had been told the material and adverse facts which had been withheld from them. Giving full weight to those cases would reach only to the point, at the conclusion of both exchange offers, at which Bangor

Punta owned 45% and Chris-Craft 41%. (477A-478A) The control of Piper—the control Chris-Craft claims was unlawfully taken—had not yet been obtained by either contestant.

Indeed it was apparent at that point to both contestants that neither could hope to win the day with paper, for both exchange offers had been spurned by the holders of more than half the shares outstanding and in the hands of noncombatants at the start of the competing offers.

What was demanded was cash. Bangor Punta had it and spent it, and Chris-Craft either did not have it or did not choose to spend it. This determined the contest, not any unlawful activities of defendants.

The logical absurdity of the "rule of law" apparently established by the Court of Appeals in this case is exposed if one assumes that Bangor Punta had stopped short of buying control after the exchange offer or had bought enough additional shares for cash so the shares acquired on the exchange offer were not needed to assure control. Where would the Court of Appeals' new rule of law lead then?

This is further confirmed by Judge Timbers' own statement (Jt. App. H-61) that if Chris-Craft had persisted in purchasing stock until it attained the majority, rather than giving up the fight as it did, "it would not have sustained damages from being put in a minority shareholder's position."

It was clearly these supervening events which caused the damages for which Chris-Craft claims relief, not any act of Petitioner as a statutory "underwriter" for the competing exchange offer. The instant case in substituting a supposed rule of law for the usual proof of proximate cause represents a gross distortion and misapplication of the *Mills* and *Affiliated Ute* cases, the effect of which is to discard altogether any proof of a causative connection between defendant's actions and plaintiff's injury in all securities act cases. When combined with the Court of Appeals' rulings on standing and *scienter*, the net effect is that

anyone who has the misfortune to find his judgment questioned by a Court of Appeals with the gift of 20/20 hindsight is, *as a matter of law*, liable to every claimant for any damages he may assert.

No case decided by this Court supports such a result.

IV. The opinion of the Court of Appeals, in riding roughshod over the "clearly erroneous" standard of Rule 52(a) and then making its own findings of fact in favor of the party having the burden of proof, has so far departed from the customary usages of the judicial system as to require supervision by this Court in the interests of justice.

Judge Timbers states (Jt. App. H-37):

> "Our disagreement with the district court on whether defendants have violated § 14(e) does not go to its findings of fact, as to which the 'unless clearly erroneous' test applies, but to its application of the legal standards just discussed."

The lack of candor in that statement is implicitly acknowledged in the modification of the mandate which resulted from the petitions for rehearing. (Jt. App. I-2)

The petition filed on behalf of the individual First Boston defendants stated:

> "The inexplicable view of the facts taken in the main opinion is nowhere better demonstrated than in the author's treatment of the individual First Boston defendants.
>
> "Neither the comprehensive district court opinion, nor the stipulated findings of fact, nor the weeks of testimony at trial, nor the myriad of exhibits introduced at trial—none of them—showed any personal participation by Mr. Miller or Mr. Bayard in the preparation of the registration statement or in the studies and inquiries related to its preparation. The record shows that John Laeri, another Vice President of First

> Boston, not a defendant in the action, was the individual officer involved in the preparation of the registration statement. (1658-59A, 1762A)"

In denying the petitions, the Court of Appeals acknowledged its error in thus departing from orderly judicial fact-finding procedures by amending its opinion to add the following sentence:

> "*In view of the voluminous record*, upon remand, the district court shall determine from the record whether, under the principles of liability regarding First Boston and its officers in this opinion, Paul L. Miller and Nicholas H. Bayard, or either of them, is individually liable." (Jt. App. I-2) (Italics supplied)

The record is no more nor less voluminous as to First Boston itself than it is as to the individuals referred to, and the *de novo* finding of facts by the Court of Appeals without support in the record is equally egregious as to First Boston.

The main opinion by Judge Timbers proceeds from a rather tentative statement (Jt. App. II-48) that questioning of the management "*appears* to have been the full extent of First Boston's investigation", through an examination of the due diligence defense under Section 11 of the 1933 Act, for which the burden of proof is placed on the underwriter (which is totally irrelevant since it is admitted Chris-Craft has no standing to sue under Section 11) to a declaration that First Boston was "duty-bound to make a reasonable further investigation". The main opinion then finds as a fact, dropping the word "appears" which it had previously used, that First Boston did not do so. (Jt. App. H-54) The court's unwarranted assumption as to this matter is simply not true, and it cannot be found to be true on the record in this case. The testimony at trial, the exhibits and the stipulated findings and the district court opinion provide no support for this categorical finding of fact by the appellate court.

Moreover, the main opinion fails to note that such verification methods as First Boston did employ produced the same conclusion which Judge Pollack reached after supervising years of discovery and presiding over a comprehensive trial—namely that Bangor Punta had not reached a decision to sell and that such a sale was not a "reasonable probability". (84A)

By innuendo referring to "questionable accounting techniques" (Jt. App. H-43), not in fact challenged, the main opinion obscures the fact that the amount at which the railroad was carried was concededly proper accounting and that as Judge Mansfield states (Jt. App. H-43) "a person able to read a balance sheet would probably have recognized that such 'historical' cost did not necessarily represent current liquidating value."

In addition to the propriety of the accounting, there was also evidence before the trial court concerning tax savings which, if the transaction were done properly, would have been sufficient to avoid any loss to Bangor Punta, and further to the effect that any sale of the railroad, even on the terms ultimately accepted, would have been, and was in fact, viewed as a highly favorable development from the point of view of holders or prospective purchasers of Bangor Punta securities. As shown by the income statements (excerpted at page 9, *supra*), the BAR was not a profitable investment, and earnings are the primary consideration in fixing security values, not historical balance sheet figures.

Without so much as a bow to the contrary findings below and the ample support in the record for them, the main opinion simply asserts (Jt. App. H-55) that "First Boston's certification of the BPC registration statement carrying the BAR at $18.4 million amounted to an almost complete abdication of its responsibility to potential investors, to CCI and to others who relied upon it to detect misrepresentations."

It is submitted that the true test of *scienter* under the Securities Laws—which must be a question of fact at

bottom—ought to be one of basic honesty and fair dealing. That is a standard men can live with, for they themselves know when they are conforming to that standard. But more importantly, in assessing *scienter*, no matter how the test is described, the feel for the case and the people involved gained by the trial court should receive more respect than the Court of Appeals has shown it for Judge Weinfeld's contrary conclusions. He saw and heard the actors in the flesh. The appellate court drew inferences from selected portions of a lifeless record, and on that basis [illegible] testimony the trial court refused [illegible] parties the trial court found to [illegible] doing and (iii) thus created a [illegible] honor and fortune is at the mercy of the last judge to speak, even though that last judge remained at all times remote from the arena. No matter how the rule of law is phrased, there is no gainsaying the fact that the trial judge, who saw and heard the witnesses, found that candor and honesty lay on the side of defendants, and that it was Chris-Craft's witnesses whose testimony under oath was not worthy of belief. See *U. S. v. National Association of Real Estate Boards*, 339 U. S. 485 (1950).

Judge Timbers, who never laid eyes on the Chris-Craft witnesses, chose to believe them although the trial judge had not. Judge Timbers found other facts—such as the full nature and scope of First Boston's due diligence investigations—without any witnesses or other evidence to support him.

In the interests of justice and orderly judicial administration, such fact finding at the appellate level must be curbed.

Conclusion

For the foregoing reasons, a writ of certiorari should issue.

Respectfully submitted

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July 20, 1973

ADDENDUM

Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C. §§ 77k and l:

"Sec. 11. (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

* * *

"(5) every underwriter with respect to such security.

* * *

"(b) Notwithstanding the provisions of subsection (a) no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

* * *

"(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements

therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and

* * *

"(C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert . . . .

* * *

"(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

* * *

"(e) The suit authorized under subsection (a) may be to recover such damages as shall represent the difference between the amount paid for the security (not exceeding the price at which the security was

offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: Provided, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. *In no event shall any underwriter (unless such underwriter shall have knowingly received from the issuer for acting as an underwriter some benefit directly or indirectly in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public.* In any suit under this or any other section of this title the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount

sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

* * *

"(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public." (Italics supplied)

"Sec. 12. Any person who—

* * *

"(2) offers or sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."